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ABSTRACT

The income tax status of various assistantships, internships, fellowships, and scholarships has been the subject of much confusion. This paper examines the various rulings and policies of the Internal Revenue Service for the use of members of the university community. Emphasis is placed on scholarship or fellowship grants; tax exempt revenue rulings; reasons why assistantships and internships are not within the tax exempt scholarship and fellowship grant category and taxable revenue rulings. (MJM)

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THE TAX STATUS OF INTERNSHIPS
AND OTHER FIELD EXPERIENCE EDUCATION PAYMENTS

Office for Experiential Education
University of Kentucky

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Preface

The income tax status of various assistantships, internships, fellowships, scholarships, etc., has been the subject of much confusion. This paper is an attempt to place the various rulings and policies of the Internal Revenue Service in a coherent form for the use of members of the university community. The following analysis consists of paraphrases, quotations and compilations from the following sources:

1. Tax Court: Memorandum Decisions. Commerce Clearinghouse, 1971-1973.
2. U.S. Tax Cases. Commerce Clearinghouse, 1967-1972.
3. Tax Information For American Scholars in the U.S. and Abroad. U.S. Department of the Treasury, Publication 520.
4. Tax Information on Scholarships and Fellowships. Department of the Treasury, Publication 507.

Dr. Emmett Costich has also been most helpful in providing documentation compiled during a test case to determine the tax status of residents and interns at the Chandler Medical Center.

C. Kathryn Shelton
Robert F. Sexton

IRS Code, Section 117

Whether a given sum of money or income is taxable or non-taxable is based not on what the income is called, but rather on whether it fits under the Internal Revenue Service category of scholarship or fellowship grants.

Section 117 of the Internal Revenue Service Code of 1954 provides the basis for the exclusion of scholarship or fellowship grants from taxable income.

Under this section, a scholarship or fellowship grant is defined as "an amount paid or allowed to an individual for the primary purpose of furthering the education and training of the recipient in his individual capacity." (IRS publication 507.) Whether an amount received by an individual is excludable from his gross income depends upon the facts and circumstances under which the payment is made. Section 1.117-4(c) of the Income Tax Regulations provides that any amount or amounts paid or allowed to, or on behalf of, an individual to enable him to pursue studies or research shall not be considered to be an amount received as a scholarship or fellowship grant if:

1. such amount represents payment for services which are subject to the direction or supervision of the grantor.
2. such amount represents compensation for past, present, or future employment services (e.g., terms of grant stipulate that student must work for the grantor firm following graduation), or
3. if such studies or research are primarily for the benefit of the grantor. (IRS publication 507 and 520)

Since any of these conditions will negate the existence of a scholarship or fellowship grant, the term "fellowship" or scholarship should be used if possible and terms such as "payment," "compensation," and "paid vacation" should be avoided.

If the grant does fulfill all of the criteria of a non-taxable fellowship grant as defined by the IRS, the type of institution giving the grant is immaterial to the tax status of the grant. However, the funds used for the grant should be separate from the institution's regular payroll account.

Revenue Rulings---Tax Exempt

In addition to the general statements found in the Code, the IRS policies are modified by specific Revenue Rulings (usually referred to as RR 71-379, etc., where the first digits represent the year). These rulings explain the current policy for specific categories of cases. The following cases are among those having been ruled as tax exempt scholarships or fellowship grants, according to IRS publications 507 and 520.

1. "No strings attached" educational grants where:
 - a) no service is performed or any part-time service is required of all degree candidates.
 - b) the course of study or research is the choice of the student.
2. Any amount received in the nature of a family allowance as part of an established fellowship grant.
3. Amounts specifically designated as being for expenses under the fellowship grant and expended for this purpose.
4. Work-Study programs. The value of tuition and work payments awarded to students are scholarships if the awarding college has no tuition charge and under its educational philosophy, requires all its students to participate in a work program. (If the college has a tuition charge, such amounts are taxable.) (Public Service Internship News, September-October, 1973, National Center for Public Service Internship Programs, page 3.)
5. Public Health Service awards to students enrolled in advanced courses of training for professional nurses are scholarships.

6. The value of room and board furnished by an accredited school of nursing to a student is a scholarship.
7. A research fellowship grant awarded by the American Heart Association, Inc. to aid individuals in pursuing further training subject to the approval of the Association qualifies as a fellowship grant since complete freedom in research is given.
8. If an educational institution maintains or participates in a plan whereby the tuition of a child of a faculty member of the institution is remitted by any other participating educational institution attended by such child, the amount of the tuition so remitted shall be considered a scholarship.
9. Stipends to graduate students under Title IV of the National Defense Education Act of 1958, to assist them in preparing for careers as teachers in colleges and universities are excludable as scholarships and fellowships.
10. Educational benefit payments received by students under the War Orphans Educational Assistance Act of 1956 are excludable as a scholarship or fellowship grant.
11. Government grants. Amounts received by U.S. citizens for study and research abroad under the Fulbright Act and the United States Information and Educational Exchange Act of 1948 are a scholarship or fellowship grant. However, amounts received under these acts for lecturing and teaching abroad are compensation for services performed and are includable in income.

If an amount received is determined to be a scholarship or fellowship grant under the Code, a degree candidate may exclude the full amount of the grant from his gross income. A student who is not a candidate for a degree may exclude from gross income an amount up to \$300 times the number of months for which the grant extends. There is, however, a lifetime limit of 36 months for which a non-degree exclusion may be used.

Explanation of IRS Code, Section 117 L

Assistantships and internships are generally not within the IRS tax exempt scholarship and fellowship grant category on one of two grounds: 1) that they are compensation for services

or 2) that they are primarily for the grantor's benefit. The following is the IRS explanation of these two exclusions quoted from Tax Information for American Scholars in the U.S. and Abroad:

Compensation for Services

"Payments that represent compensation for past, present, or future services performed by you are not excludable. Amounts received by students for services performed on a research project, which a university contracted to perform for consideration, are compensation regardless of how such consideration is designated. Such amounts are not converted to scholarships or fellowship grants merely because the research can be used for credits toward degrees or may be required to obtain a degree. Normally, if the services are required of all candidates for a particular degree (whether or not recipients of scholarships or fellowship grants) as a condition of receiving the degree, the compensation for the services may be excluded."

Primarily for Grantor's Benefit

"The amounts paid to aid you in pursuing your studies or research are not excludable if the studies or research are primarily for the benefit of the grantor. However, if the primary purpose is to further your education and training, and the amounts do not represent compensation for services, neither the fact that you are required to furnish reports of your progress nor that the results of your studies or research may be of some incidental benefit to the grantor shall, of itself, destroy the character of such amounts of scholarships or fellowships."

More specifically, on the subject of graduate student teaching assistantships, the same source states:

"Generally, such teaching assistantships are includable in income. To be excludable these assistantships must meet the general requirements of a scholarship or fellowship grant. It is immaterial that the teaching requirement is imposed on all candidates for the graduate degree since the exclusion from income is inapplicable unless it is first established that a scholarship or fellowship grant exists."

It was recently ruled that teaching assistants in the English department of the University of Illinois were subject to tax even though teaching was a requirement for the degree. The grants were determined to be "primarily for the benefit of the grantor."

Two recent court cases, Edward A. Jamison, 1969 (teaching assistant, University of New Mexico) and Robert V. and Svaja Worthington, 1972 (teaching assistants, University of Tennessee), further explain the IRS philosophy on graduate teaching assistants. In both cases the income was ruled taxable on the grounds that the assistantships were "primarily for the grantor's benefit" and thus compensation for services rendered. In both cases, the funds were allocated from the instructional segment of the university budget rather than from the student aid segment, and the number of graduate assistantships actually given was based on the number of assistants needed for teaching purposes rather than the total number of graduate students. (U.S. Tax Cases, Commerce Clearinghouse, 1969 and 1972).

Revenue Rulings---Taxable

The following categories of grants have also been specifically deemed taxable by IRS Revenue Rulings quoted in publication 520 and 507.

1. Interns and resident physicians in a hospital who primarily perform services for the hospital, are receiving compensation for services performed. This is true even if the hospital is operated by a university as part of a medical school. Leathers and Blankenship vs. U.S., 1973, may modify this ruling to allow \$3,600 to be excluded from gross taxable income.

2. Scholarship prizes won in a contest where there is no requirement that a prize be used for educational purposes, are not scholarships or fellowships. They must be included in the recipient's gross income whether or not the amounts are eventually used for educational purposes.
3. Amounts paid to student interns to state legislatures and to state political leaders, who are required under a grant to perform routine office work and various assignments for the benefit of the legislatures and the political leaders represent compensation for personal services.
4. Amounts received by interns of a social service agency's training program who perform services for the agency, even though training and experience are acquired incidentally in performing these services, are compensation for services performed.
5. If a student is required, as a condition for receiving a scholarship to agree to work for the grantor after completing training, the scholarship is considered compensation for future services.
6. Repayment by an employer of a scholarship loan or federal "forgiveness" clauses of scholarship loans previously received are classed as additional compensation for services rendered and includable in gross income.
7. Stipends paid to journalism students working as regular staff employees of certain newspapers and paid through a university are compensation for services performed.
8. Payments to National Teacher Corps teacher interns during training and in-service periods do not qualify as fellowships.

Conclusion

In short, it would appear that any obligation placed upon the student either in terms of future employment or current services, or any restriction placed on the course of study or type of research, would lead to questions concerning the acceptability of the grant as excludable income. It becomes the obligation of the recipient to prove that the primary purpose of the grant is to further his or her individual education or research.

If a grant recipient has some question on the tax status of his or her grant, he or she may receive an "advisory opinion" from the IRS by writing:

Office of the District Director
P.O. Box 1146
Internal Revenue Service
Louisville, KY 40201

or

Commissioner of Internal Revenue
Washington, DC 20224

In asking for the "advisory opinion," the following documents must be enclosed.

1. A copy of the application for the grant.
2. A copy of the grant itself.
3. A statement as to whether the recipient is a candidate for a degree.
4. A statement as to whether any amounts are received specifically to cover expenses for travel, research, clerical help, or equipment incidental to the scholarship or fellowship grant.
5. A statement showing precisely what your duties and obligations are under the grant. (For example, whether the recipient has freedom of choice in studies or research or if they are performed subject to supervision and control; also, whether they are accomplished during the course of a specific project of the grantor.)
6. A copy of any published literature or pamphlets describing the grant.